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39	A	B	C	D	E

PRACTICE QUESTIONS

Fitch Learning (formerly Moody's Analytics)

RR3E

Retail Risk III

EDITION

Demo

QUESTIONS

9

FORMAT

Limited Edition PDF

Before you begin

What this is

9 practice questions for Fitch Learning (formerly Moody's Analytics) **RR3E**, each with its answer key and an explanation. Answer a question before you read its key — the explanation is worth more once you have committed.

If something looks wrong

Send us three things and we will check it:

- the exam code, **RR3E**
- the question number
- the email address on your order

Write to **support@mometrix.net**. We reply within one business day.

QUESTION 1 SINGLE CHOICE

Which of the following best describes the role of the Probability of Default (PD) within a retail credit scoring framework?

- ☐ A An estimate of the proportion of the outstanding balance that will be lost if a customer defaults
- ☒ B An estimate of the likelihood that a customer will default within a defined horizon
- ☐ C An estimate of the total facility size the customer is likely to draw down at default
- ☐ D An estimate of the expected return on a retail loan after adjusting for fees

ANSWER B

WHY PD is a forward-looking measure of the likelihood that a borrower will default within a specified time horizon. Loss Given Default (LGD) is the proportion of the exposure lost, and Exposure at Default (EAD) is the expected drawn balance at default. Option A describes LGD, option C describes EAD, and option D does not describe any of the core IRB parameters.

QUESTION 2 SINGLE CHOICE

An analyst builds an application scorecard for new retail credit card applicants. Which data source is most appropriate as the development population?

- ☐ A All existing card customers currently in good standing
- ☒ B Recent applicants for whom both application data and at least 12 months of performance/outcome data are available
- ☐ C Customers who have already defaulted, selected to match the applicant base on age and income
- ☐ D Declined applicants reconstructed using internal fraud records

ANSWER B

WHY Scorecards must be developed on a representative sample where both the predictor variables (application data) and the outcome (good/bad performance) are observable. Using only existing good-standing customers creates survivor bias, using only defaulters is a biased bad sample, and declined applicants are not representative of the through-the-door applicant population.

QUESTION 3 SINGLE CHOICE

In a workout LGD model for unsecured retail lending, why are discount and recovery costs typically included as separate components alongside cash recoveries?

- ☐ A They are excluded under Basel rules and only used for IFRS reporting
- ☒ B They reduce the effective recovery amount and must be netted against inflows before computing LGD
- ☐ C They are only relevant for secured portfolios
- ☐ D They are added to gross loss to compute the downturn LGD

ANSWER B

WHY Gross LGD ignores costs; net LGD subtracts both the time-value discount on recoveries and the operational costs of recovery (legal, collections, asset disposal). These components directly reduce the realised recovery and so must be incorporated into the LGD calculation. They are not Basel-excluded, they apply to both secured and unsecured portfolios, and they are subtracted rather than added.

QUESTION 4 SINGLE CHOICE

Which statement about Credit Conversion Factors (CCFs) for revolving retail facilities is most accurate?

- ☐ A CCFs for retail revolving exposures are fixed at 75% under all Basel frameworks
- ☒ B CCFs convert undrawn commitment into expected drawn amount at default and are typically estimated from internal default data
- ☐ C CCFs are only relevant for corporate exposures and never used for retail
- ☐ D CCFs are used to convert EAD into PD

ANSWER B

WHY The CCF expresses the proportion of an undrawn limit that is expected to be drawn at the moment of default, so that $EAD = \text{drawn} + CCF \times (\text{limit} - \text{drawn})$. For retail revolving exposures, institutions typically estimate CCFs from internal data when permitted by the regulator. They are not fixed at 75%, they do apply to retail exposures, and they convert undrawn commitment into EAD — not EAD into PD.

QUESTION 5 SINGLE CHOICE

What is the primary purpose of a macroeconomic overlay when applied to a through-the-cycle (TTC) PD model in retail credit risk?

- ☐ A To replace the TTC PD with a point-in-time estimate that fluctuates with the economic cycle
- ☒ B To adjust the long-run average PD so it reflects expected deterioration or improvement under a specific forward-looking scenario
- ☐ C To recalculate the customer-level behavioural score
- ☐ D To recalibrate the LGD curve independent of PD

ANSWER B

WHY A macroeconomic overlay takes a stable TTC PD and shifts it to reflect a forward-looking scenario (e.g. an adverse stress) so that the portfolio view remains point-in-time or scenario-consistent without rebuilding the underlying scorecard. It does not replace the TTC PD wholesale, it does not alter the behavioural score itself, and it is not used to re-derive LGD.

QUESTION 6 SINGLE CHOICE

A behavioural scorecard for an existing retail customer is best described as:

- ☐ A A score built only at origination using the application form
- ☒ B A score that updates over time using internal performance data such as utilisation, delinquency and payment recency
- ☐ C A macroeconomic indicator used for stress testing
- ☐ D A regulator-prescribed PD value

ANSWER B

WHY Behavioural scorecards use internal account-level performance information (e.g. months on book, utilisation, delinquency, payment recency) and are refreshed as new behaviour is observed, distinguishing them from application scorecards built only at origination. They are not macroeconomic indicators or regulator-set PDs.

QUESTION 7

SINGLE CHOICE

A retail portfolio has an average PD of 4%, an average LGD of 45% and an average EAD equal to the outstanding balance. Unexpected loss (UL) for the portfolio differs from Expected Loss (EL) primarily because UL:

- ☐ A Is the average loss across all states of the world
- ☒ B Captures the variability of losses around their expected level due to dispersion of defaults and recoveries
- ☐ C Equals EL multiplied by the average PD
- ☐ D Ignores the effects of correlation across borrowers

ANSWER B

WHY Expected loss is the mean loss: $EL = PD \times LGD \times EAD$. Unexpected loss measures the dispersion of the loss distribution around its mean at a chosen confidence level (e.g. 99.9%) and depends on default correlations and the volatility of LGD/EAD. Option A describes EL, not UL, and correlation across borrowers is precisely what generates the portfolio-level UL, so it is not ignored.

QUESTION 8

SINGLE CHOICE

Which pair of performance metrics is most commonly used to monitor the discriminatory power and calibration of a retail PD scorecard over time?

- ☒ A Gini coefficient (or AUC) for discrimination; Hosmer–Lemeshow or binomial test for calibration
- ☐ B R-squared for discrimination; mean absolute error for calibration
- ☐ C Sharpe ratio for discrimination; tracking error for calibration
- ☐ D KS statistic only; Gini only

ANSWER A

WHY Discrimination is measured by the Gini coefficient (or AUC, both based on the ROC curve) and calibration by tests comparing predicted PDs to observed default rates (Hosmer–Lemeshow, binomial test, Brier score). R-squared and MAE are regression metrics not used for binary default outcomes, and KS/Gini alone cover only one dimension each.

QUESTION 9

MULTIPLE CHOICE

When designing an acceptance cutoff for a retail credit application scorecard, which of the following are typically considered? (Choose two.)

- ☒ **A** The marginal risk-adjusted return of accepting the next decile of applicants
- ☐ **B** The forecast inflation rate for the next calendar year only
- ☒ **C** The expected volume of approvals and resulting portfolio mix at each cutoff
- ☐ **D** The exchange rate used to translate foreign-currency funding costs

ANSWER A • C

WHY Cutoff setting balances the marginal risk-adjusted return of approving additional applicants against the expected approval volume and resulting portfolio risk mix. General inflation and FX translation decisions are firm-wide funding/pricing decisions, not direct inputs to the scorecard cutoff.